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INFO RUCNFRG/FRG COLLECTIVE
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UNCLAS SECTION 01 OF 03 BERLIN 000833

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E.O. 12958: N/A

TAGS: [ELAB](#) [ECON](#) [PGOV](#) [PREL](#) [GM](#)

SUBJECT: G-8 LABOR MINISTERIAL: SCENESETTER FOR ASSISTANT SECRETARY OF LABOR DEROCCO

¶11. Welcome in advance to Germany and to this year's meeting of G-8 labor ministers, hosted by Germany's Ministry of Labor and Social Affairs May 6-8 in Dresden, the capital of the eastern state of Saxony. Like the other states of the former German Democratic Republic, Saxony still lags behind the western states in economic terms; but it is growing fast, and cities like Dresden and Leipzig, the largest city in Saxony, are among the most prosperous in the former GDR. Dresden is also rebuilding from the massive destruction it suffered during World War II, as you will see when you visit the newly restored Church of Our Lady.

¶12. You will also see a Germany experiencing overdue economic growth, due primarily to booming exports and a recent rise in investment spending. Unemployment levels, declining but still high, are the indicator most watched by German officials and politicians. Germany under Chancellor Angela Merkel has resumed its old role as engine for European and global economic growth, despite the continued and longstanding need for structural reforms in labor, business regulations, taxation and other areas.

Germany: Political and Economic Overview

¶13. Now half way through its second year in office, the Chancellor's grand coalition between her own party, the right-of-center Christian Democratic Union (CDU, joined by its Bavarian sister party the Christian Social Union, or CSU), and the left-of-center Social Democratic Party of Germany (SPD) is in good shape and seems likely to survive until its four-year term expires in 2009. Merkel's consensus-style leadership keeps a lid on tensions between the two parties, Germany's largest and traditional opponents, and wins her high ratings in public opinion polls. She seems to have forged a good working relationship with SPD Vice-Chancellor and Minister of Labor and Social Affairs Franz Muentefering. She is a strong advocate of close ties with the United States, and bilateral relations have improved since she took office in November 2005. Among the German people, however, skepticism about the United States over the invasion of Iraq, climate change, counter-terrorism, and other issues remains high.

¶14. The German economy in 2006 had its best year since 2000. Its GDP grew 2.7 percent and economists have revised their 2007 and 2008 forecasts upwards to 2.4 percent. Tax revenues are up and the government's budget deficit is now well within the European Union's "Maastricht criteria" (3 percent of GDP). Business confidence is high. Employment is increasing and some employers complain of a shortage of skilled workers. Unemployment dropped in March to a six-year low of 9.2 percent, seasonally adjusted, and economists now forecast annual unemployment of 8.7 percent in 2007. (Unemployment

is still nearly twice as high in the states of the former GDR, however, and long-term unemployment also remains high in the Ruhr and some other parts of western Germany where old smoke-stack industries have shut down in the face of global competition.) German companies have cut costs, and labor productivity per capita rose 1.8 percent in 2006. Germany's trade unions feel they might be regaining political and economic power and after years of wage restraint are again demanding higher pay. Although unions only represent about 25 percent of German workers, union contracts cover 65 percent of the workforce.

Traditional Social Partnership under Stress

15. Comprehensive collective bargaining agreements between unions and employers' associations, covering entire industries, were for years the rule in Germany, ensuring a remarkable degree of industrial peace. This system is starting to break down: both unions and employers' associations are losing members and the unions find themselves having to negotiate contracts that give individual firms greater flexibility to meet the demands of global markets. Employee participation in company management through elected works councils, and employee representation on corporate supervisory boards (co-determination), are enshrined in German law but are also under stress, with employers arguing co-determination impedes competition in the global economy, an argument the unions absolutely reject. Even in the chemical industry, where labor-management relations are perhaps the best in the country, union leaders have begun openly to question whether the concept of a social partnership is still valid.

16. These issues are reflected in the theme for this year's G-8 labor ministerial: "Shaping the Social Dimension of Globalization." Muentefering argues EU governments must show themselves willing and

BERLIN 00000833 002 OF 003

able to influence global economic integration to preserve the achievements of the social welfare state. The dynamics of the coalition government are a potent factor in this. Some in the SPD argue the Christian Democrats are stealing the Social Democrats' thunder on social issues, and that the SPD must sharpen its social profile if it is to have any hope of returning to power in federal elections in 2009. Muentefering, a former SPD chairman, put it this way at a conference last year: Germans see globalization as a direct attack on the achievements of the social market economy. Governments must show they can regulate globalization, he said, or the voters will be tempted to turn to a strongman to lead them.

Principle Labor and Social Issues

17. The Low-Wage Sector: Although primarily a high-wage, high-skill economy, Germany has a significant low-wage sector which earlier governments promoted in an effort to reduce high unemployment. There is concern the number of working poor is on the rise. The federal government reports that in 2004, 18.4 percent of full-time workers earned less than two-thirds of the median wage, up from 16.6 percent in 1993. Unlike most EU countries Germany has no across-the-board minimum wage, and the German Trade Union Federation is now demanding a national hourly minimum wage of 7.50 euros (\$9.50). But even in the SPD there is some disagreement with this idea and the CDU/CSU strictly opposes a minimum wage, favoring instead a "combination wage" under which a government benefit would be paid to low-wage workers.

18. Older Workers: Both houses of parliament have approved an initiative Muentefering launched last year called "50-Plus," to increase employment opportunities for older workers. Only 45 percent of Germans aged 55 to 64 are employed and over a quarter of the unemployed are 50 or older. Muentefering argues the situation must change and Germany cannot afford to waste the potential older members of the workforce offer. The government cut incentives for early retirement, shortened the period of eligibility for unemployment compensation, ended the early retirement option for persons 58 and older, and introduced a "combination wage" for unemployed older workers who take a job that pays less than they previously earned. The initiative also includes wage subsidies for employers who provide jobs to older workers and supplementary

training assistance for workers 45 and older.

¶9. Pensions: For the first time in three years, pensioners in Germany will receive more money. Muentefering announced old-age pension rates will rise 0.54 percent as of July 1, reflecting higher wages and salaries over the last year. By law, pension benefit increases are tied to wage growth in the preceding year.

Conversely, benefits can also be cut or frozen if wage developments warrant, as was the case over the last three years. Still, about 20 million pensioners face a de facto freeze on pension benefits in the coming years. Defying union protests, parliament on March 30 fulfilled an agreement between the grand coalition parties and voted to raise the retirement age from 65 to 67, to deal with a pension funding crisis resulting from Germany's low birth rate and ageing population. Under the new law, everyone seeking retirement earlier than 67 will face a monthly pension cut of 0.3 percent. Meanwhile a decision to increase employer-employee payroll contributions to the pension system from 19.5 to 19.9 percent of gross income has been widely criticized as undermining the effort to lower non-wage labor costs.

The Hartz Reforms

¶10. The Ministry has thoroughly reviewed Germany's initial labor market reforms, called Hartz I-III after former Volkswagen Personnel Director Peter Hartz, who was instrumental in their adoption. An additional reform, Hartz IV, passed in 2004, was particularly controversial, inspired public demonstrations, and contributed to the defeat of the SPD and the rise of a new leftist party in the 2005 federal election. The Ministry says some elements of the initial three reform packages, such as make-work programs for hard-to-place long-term unemployed, have proven ineffective. Other measures, such as restructuring the Federal Employment Agency to make it more service-oriented and promoting vocational training or re-integration subsidies, have been largely successful. Still to come is a review of Hartz IV, which merged unemployment benefits and social assistance beginning in 2005.

Co-Determination

BERLIN 00000833 003 OF 003

¶11. An expert commission appointed by former Chancellor Schroeder in July 2005 reported to Chancellor Merkel last December that Germany's 1976 law mandating worker representation on corporate supervisory boards ("co-determination") has proved its worth and does not need fundamental changes. Chaired by former CDU Minister-President of Saxony Kurt Biedenkopf, the commission was composed of three members each from academia, business groups, and employees' organizations. Business and employee members could not agree on a joint reform proposal and left the commission in mid-November last year, and the report was issued in the name of the academic members only. The businessmen argued co-determination should be voluntary, with at most a third of the seats on supervisory boards reserved for employee representatives, rather than as many as half, as required under the current law. They said the law puts German companies at an international competitive disadvantage. The academic and employee members rejected this argument, although the report does recommend certain changes to adapt co-determination to companies with employees outside Germany.

Collective Bargaining

¶12. After years of wage moderation, unions and workers are now demanding part of the fruits of the economic upswing. The powerful Metal and Electronics Workers' Union, IG Metall, wants 6.5 percent more pay for its 3.4 million members, but the employers' association Gesamtmetall has offered only 2.5 percent, plus a 0.5 percent lump-sum payment for the year. IG Metall has announced plans for warning strikes, which will spur the sides to narrow differences. Meanwhile, unions and employers in the chemical sector have quietly hammered out a deal giving 550,000 employees a 3.6 percent pay hike plus a lump-sum payment of 0.7 percent of their annual salary. Construction industry employers and unions have agreed on a 3.5 percent wage increase covering nearly 700,000 workers, and a lump-sum payment of 0.4 percent which can be negotiated on a company

basis.

¶13. The Apprenticeship Training System: Germany's "dual system" of vocational training, which combines on-the-job training with vocational school attendance, has long proved to be an effective tool in reducing youth unemployment, which in Germany is relatively low (EU-15 average: 16.5 percent; Germany: 15.2 percent, 2005 data). However, an upward trend in youth unemployment in recent years prompted the German government, employers, and industry associations to agree on a voluntary job training pact on creating more training opportunities. Last month the pact was extended until ¶2010. Business associations agreed to provide 60,000 new training slots each year, twice as many as before. Nevertheless, German trade unions and opposition parties complain the number of applicants surpasses the number of slots available and are demanding the introduction of a compulsory "training levy" on companies which do not provide sufficient training opportunities.

¶14. Health Care Reform: After months of political bickering, a health care reform bill went into effect April 1. The initial goal of completely overhauling the healthcare system to ensure its sustainability in the face of demographic and budgetary constraints was dramatically scaled back over months of argument within the coalition and in parliament. Minister of Health Ulla Schmidt (SPD) failed to obtain many of the structural changes she had sought, including the "disarming" of powerful statutory health insurance funds and physicians' federations. The outcome is legislation that is unlikely to result in the savings necessary to shore up the country's healthcare system, which may lead politicians to look again at further regulation of pharmaceutical pricing—an issue which has already spurred bilateral disagreement with the United States. Although the Ministry of Health has the lead on this issue, the Ministry of Labor and Social Affairs is a player as well.

TIMKEN, JR.